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STB EX PARTE NO. 582 (SUB-NO. 1)

MAJOR RAIL CONSOLIDATION PROCEDURES

REPLY COMMENTS

SUBMITTED BY THE

U.S. DEPARTMENT OF AGRICULTURE

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Washington, D.C. 20250

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AUTHORITY AND INTEREST

The Secretary of Agriculture is charged with the responsibility under the Agricultural Adjustment Act of 1938 and the Agricultural Marketing Act of 1946 to represent the interests of agricultural producers and shippers in improving transportation services and facilities by, among other things, initiating and participating in Surface Transportation Board (Board) proceedings involving rates, charges, tariffs, practices, and services.

The U.S. Department of Agriculture (USDA) strongly supports the Board's proposal that Class I railroads which seek to merge be required to enhance rail-to-rail competition as a condition for a proposed merger's approval. USDA is convinced that competition between rail carriers is the essential ingredient needed to encourage improved customer service in the railroad industry, preserve the economic vitality of the railroad industry and protect shippers from the abuse of railroad market power. Due to the magnitude of economic harm further major railroad mergers potentially can inflict on shippers, communities, and other affected parties, USDA strongly opposes, at this time, any decrease in the review period of proposed mergers. USDA also supports the inclusion of rail alliances in the merger rules.

USDA REPLY TO OTHER COMMENTS:

Enhance or preserve competition?

The fundamental decision the Board must make in its final major railroad merger rules is whether the new major merger rules should enhance rail-to-rail competition or just continue to preserve competition. Shippers, shipper organizations, smaller railroads, U.S. Department of Transportation (DOT), and USDA strongly support the enhancement of rail-to-rail competition in the new major merger rules. Class I railroads, however, strongly oppose the Board's proposal that competition be enhanced as a requirement of merger approval.

USDA agrees with the National Industrial Transportation League (NITL) that "rather than preserving competition, the application of the Board's prior major rail merger policy has resulted in the loss of rail-to-rail competition as mergers over the past decade have been approved" (NITL, p.5). This is because the conditions that the Board has imposed in the past to remedy reductions in rail competition due to mergers have been treated in a very narrow manner; the Board has not imposed conditions to rectify the loss in competition when the number of railroads available to shippers has been reduced from three to two, nor has the Board adequately conditioned end-to-end mergers to prevent vertical foreclosure. ". . . the Board has lost sight of the fact that rail mergers of the size and scope of those recently approved, and of the size and scope that could take place in the future, result in systemic losses in competition . . ." (NITL, p.8). Not only have shippers lost competition provided by carriers over part of a rail movement when mergers involving the combination of end-to-end routes have been permitted without ameliorating conditions, but shippers have also lost product and geographic competition (NITL, p.5-6).

Many other comments submitted by shippers in both *Ex Parte 582* and *Ex Parte 582 (Sub-No. 1)* clearly indicate that past Class I railroad mergers have resulted in significant losses of rail-to-rail competition and abuse of Class I railroad market power. Indeed, the problems associated with recent Class I railroad mergers have led us to this very policy debate, but the Class I railroads blame the Board for proposing that enhanced competition be required as a condition of future major railroad mergers.

Despite overwhelming shipper comments detailing the abuses of railroad market power, the Association of American Railroads (AAR) states that "enhanced competition should continue to flow from voluntary, market-based initiatives, not from government mandates" (AAR, p.2). In this statement, the AAR ignores the reality that Class I railroads dictate the terms of these "market-based initiatives" since they possess significantly more market power than their shippers and connecting railroads. Does the Board really believe that AAR would espouse this line of reasoning if the situation were reversed and they lack the market power? It is precisely the government's role to prevent this "might makes right" rationale. When deregulation of an industry conflicts with the public interest and leads to market failures that harm the public interest, this is precisely the argument that justifies government examination and, if necessary and as appropriate, the introduction of market-based incentives or regulations to preserve the public interest and protect a level playing field in the market place.

AAR also states that the Board's requirement of enhanced competition in its new major merger rules would be a stark departure from the existing requirement of statute and case law that the Board address adverse effects on competition (AAR, p.1). AAR further states, "The governing statute requires that the Board consider whether a proposed transaction would have an adverse effect on competition and it authorizes the Board to impose conditions to remedy any adverse effects of a merger. The proposed rules would fundamentally change the Board's role, giving it the power to restructure railroad markets as the price for merger approval in ways the Board, not the market participants, deems appropriate" (AAR, p.3).

USDA believes that AAR is in error interpreting the legal authority of the Board to require enhanced competition as a condition of future major railroad mergers, especially since the

Board's conditions on prior railroad mergers have failed to preserve competition. Also, in its statement above, AAR acknowledges that the statute "authorizes the Board to impose conditions to remedy ***any*** adverse effects of a merger" (emphasis added). USDA believes the AAR is in error when it states that the proposed rules would fundamentally change the Board's role. Indeed, USDA asserts that the Board would be complying with what its statutory mandate, and the proposed rules merely enhance the Board's interpretation of its statutory authority, and do not fundamentally alter the Board's role or overreach the Board's statutory authority.

As other experts have noted in their observations of both the transportation industries and the government bodies charged with ensuring their competitive behavior, at stake are billions of dollars in economic benefits as well as perhaps the very success of rail regulatory reform. The implications are clear: rail intramodal competition must be encouraged in every relevant area . . . Competition should be preserved and promoted now, as undoing misguided actions will not be easy. It is important to recognize that deregulation *does not authorize the government to abdicate its antitrust responsibility and to fail to take actions to preserve competition.* To the extent that mergers can enable railroads to improve service and reduce costs without concomitant anti-competitive effects, they should be encouraged. It is the [government's] responsibility to scrutinize carefully potential anti-competitive effects from both parallel and end-to-end mergers.[1]

AAR also implies that the Board should not use its merger review authority to restructure railroad markets by mandating conditions that are unrelated to any harms caused by a proposed merger (AAR, p.2). AAR states that imposing additional conditions on a transaction "that would

[1] Winston, C., T. Corsi, C. Grimm and C. Evans, *The Economic Effects of Surface Freight Deregulation*, Brookings, Washington, D.C., 1990; and Grimm, C., "Promoting Competition in the Railroad Industry: A public Policy Analysis," *Proceedings of the Transportation Research Forum*, 1984.

yield substantial net benefits (and no unremedied competitive harms) might not be undertaken because the applicants would be required to sacrifice too large a share of private benefits through compliance with the new competitive conditions. The revenues lost through contrived restructuring of rail-to-rail competition could readily exceed a merger's expected cost savings" (AAR, p.4).

USDA contends that the competitive conditions proposed by the Board are indeed related to the harms caused by a proposed merger. The fact that the Board took a very narrow view of competitive harms in the past does not change the fact that recent mergers have resulted in substantial competitive harm to many shippers. In an effort to keep traffic on its own line and increase its share of a joint haul, the newly merged Class I railroad typically closes gateways– if not physically, then economically– thereby reducing the competitive options available to shippers. USDA asserts that too many shippers have not realized the promised benefits of Class I railroad mergers. Instead of reduced in-transit times due to single-line service, shippers have complained that in-transit times have increased. Instead of benefitting from reduced rail rates, shippers often have encountered higher rail rates to cover the costs of the premiums paid for the stock of the purchased firm and operating inefficiencies of the newly merged firm. USDA, and most of those in the shipper community, contend that the shippers have been harmed more often by major railroad mergers than helped.

USDA agrees with DOT's statement that it "supports the Board's proposal to ***require applicants to submit proposed conditions to enhance competition*** (emphasis added), particularly where there may be anti-competitive effects that are otherwise difficult to remedy... DOT supports enhancing competition through mandated open access at terminals as a way to mitigate the loss of geographic competition. Additionally, DOT believes that conditions that enhance competition, if applied judiciously, will help to ensure the national rail system's sustainability" (DOT, p. 3). DOT further states,"Offering greater competitive options to shippers generally has merit, but there should be a recognition of the need to first attempt to match awards of competitive options to the specific shippers on whom the transaction otherwise would impose losses of such options" (DOT, p.4).

USDA agrees with DOT that mandated open access at terminals will help mitigate the effects of the loss of geographic competition and again, restates our earlier recommendation that merging railroads must be required to keep all existing rail gateways open, to open those gateways previously closed, and to remedy any reductions in route or service options. Moreover, shippers should not be denied remedies in the final merger rules if they are unable to identify in advance and quantify the competitive harms due to vertical foreclosure by the railroad. In addition, shippers should not be denied remedies in the final merger rules to replace the loss of competitive options that shippers operating more than one plant lose, which result in the loss of whatever bargaining leverage the shipper had (NITL, p.7).

As the NITL states, "In focusing only on the competitive harm of parallel mergers at specific geographic points, while ignoring the competitive effects as end-to-end routes are combined, the Board has lost sight of the fact that rail mergers of the size and scope of those recently approved, and of the size and scope that could take place in the future, result in <u>systemic</u> losses in competition that geographically-specific ameliorating conditions simply do not cure" (NITL, p.8). Not only have shippers lost competition provided by carriers over part of a rail movement when mergers involving the combination of end-to-end routes have been permitted without ameliorating conditions, but also shippers have lost product and geographic competition (NITL, p.5-6).

USDA also supports further consideration of the proposal made by Ed Kemmerer (Attachment to the Comments of the American Chemistry Council and the American Plastics Council) to require the origin carrier to provide rates to the closer interchange points that are in proportion (by distance) to the rate that is offered to a longer point (adjusted for terminal costs and local service at the origin and destination points). This may be an effective method of ensuring that gateways will be kept open following mergers.

Both AAR and DOT state that the Board seems to assume, *a priori*, that there will be competitive problems arising from a merger that cannot be directly remedied and that it is premature to conclude that it will occur in all cases (DOT, p.4; AAR, p.9). Although USDA recognizes the possibility that not all railroad mergers will result in competitive problems, USDA believes that the loss of competition resulting from past major railroad mergers requires that the Board should place greater emphasis on actions to protect the shipper community from potential anti-competitive results of any mergers. Thus, USDA suggests that a rebuttable presumption – that there are competitive problems – be instituted in the new merger rules, which places the burden of proof on the railroad – where it appropriately belongs.

This burden on applicants obligates them to demonstrate that un-remediable competitive problems do not exist or are not a major factor that should affect the merger approval. This obligation further meets the Board's proposed rule that future merger applicants must include provisions for enhancing competition, to present effective plans to keep open major existing gateways, and to provide detailed service assurance plans.

Enhanced competition should apply to all railroads in a region affected by a rail merger.

If the Board decides that its final rules should enhance rail-to-rail competition, the Board must also decide the most appropriate ways of achieving this goal and whether these rules should apply only to the merging railroads or to all railroads in the affected regions.

DOT supported enhancing competition through mandated open access at terminals as a way to mitigate the loss of geographic competition (DOT, p.4) and USDA concurs (see above). In addition, NITL makes a strong argument for the Board to require that the competitive conditions be applied to all railroads serving the affected regions.

As the NITL states, "the League believes that the scope of the Board's rulemaking which is focused purely on merger policy, would create a serious disparity between the competitive conditions facing merging as compared to non-merging carriers, to the detriment of both merging carriers and the shipping public" (NITL, p.3). Thus, USDA agrees with NITL's recommendation that the Board require all carriers serving the affected gateways to be covered under the order – such a condition would preserve, and perhaps enhance, effective gateway competition.

Decreased review period for major rail mergers.

Burlington Northern Santa Fe (BNSF) has proposed a maximum review period of one year from the date of the pre-filing notification. ". . . given the end-to-end nature of likely future Class I transactions, there is no reason why the Board cannot process mergers within even shorter periods, using simplified procedures as other agencies do in reviewing mergers of comparable scope and size" (BNSF, p.6).

Due to the magnitude of economic harm further major railroad mergers potentially can inflict on shippers, communities, and other affected parties, USDA strongly opposes any decrease in the review period of proposed mergers. Shippers that have experienced arbitrarily imposed Class I railroad limitations upon routing and market access have only recently begun to realize the anti-competitive effects of end-to-end mergers. Thus, rail shippers need the current length of time provided in the merger review period to adequately assess the effect of the proposed merger upon their operations, particularly since the competitive effects of end-to-end mergers are more difficult to quantify than those effects due to parallel mergers.

A shorter review period would not allow the Board to adequately analyze the public benefits and costs of a rail merger – particularly with the Board's current limited resources. In addition, recent railroad mergers have shifted to the shippers many of the costs of service disruptions and market premiums that should be borne by the merging railroads. Thus, a shorter review period could fail to adequately protect shippers' interests.

BNSF also states that investors cannot tolerate uncertainty or delay, creating a downward pressure on railroad stocks. USDA contends that the market price of railroad stocks is being driven down because investors lack confidence in the value of the proposed merger – if investors perceive value in the merger, the market price of the stock would increase. More likely, past service disruptions and the associated costs to the merging railroads, have left the investment community skeptical of the profitability of future large railroad mergers.

Inclusion of rail alliances in the rule.

The American Chemistry Council (ACC) and the American Plastics Council (APC) state that the proposed rules "omit entirely any scrutiny of proposed marketing alliances" (ACC-APC, p.2). They further state, "... antitrust enforcement experts plainly recognize that marketing alliances can have anti-competitive effects...:"(ACC-APC, p.11). In light of these concerns, USDA urges the Board, in its proposed merger rules, to require Board approval of railroad marketing alliances and the remediation of any anti-ompetitive effects.

CONCLUSION:

In conclusion, USDA strongly supports the Board's proposal that merging Class I railroads be required to enhance rail-to-rail competition as a condition for a proposed merger's approval. USDA is convinced that competition between rail carriers is essential to improve customer service in the railroad industry, to preserve the economic vitality of the railroad industry and to protect shippers from the abuse of railroad market power. Due to the magnitude of economic harm further major railroad mergers potentially can inflict on shippers, communities, and other affected parties, USDA strongly opposes any decrease in the review period of proposed mergers. USDA also supports the inclusion of rail alliances in the merger rules.

Respectfully submitted,

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CERTIFICATE OF SERVICE

The undersigned hereby certifies that on December 18, 2000, he caused a copy of the Department of Agriculture's reply comments to be served by first-class mail, postage paid, on all parties of record in STB Ex Parte 582 (Sub-No.1).

James A. Caron
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